

# The Judges' Book

---

Volume 1

Article 9

---

9-2017

## Civil Procedure: Class Action Fee and Cost Awards

Morris Ratner

Follow this and additional works at: <http://repository.uchastings.edu/judgesbook>



Part of the [Civil Procedure Commons](#), and the [Judges Commons](#)

---

### Recommended Citation

Ratner, Morris (2017) "Civil Procedure: Class Action Fee and Cost Awards," *The Judges' Book*: Vol. 1 , Article 9.

Available at: <http://repository.uchastings.edu/judgesbook/vol1/iss1/9>

This Article is brought to you for free and open access by UC Hastings Scholarship Repository. It has been accepted for inclusion in The Judges' Book by an authorized editor of UC Hastings Scholarship Repository.

**Civil Procedure:**  
*Class Action Fee and Cost Awards*<sup>1</sup>

Morris Ratner

Class-action fee- and cost-award doctrine misaligns the interests of class counsel and the class by making the investment of attorney time more profitable than investment in case costs. Unlike time investment, which may contain a markup in the hourly rate and may also be multiplied in the fee award, a class-action lawyer's advancement of litigation costs—including filing fees, expert fees, notice costs and other disbursements—is merely reimbursed. This uneven treatment of time and cost investment in class-action litigation distorts attorney case-investment incentives.

Predictably, profit-maximizing attorneys will be less inclined to pursue high-cost cases, will favor time over cost-intensive approaches to case investment, even where cost investment would ultimately work to the advantage of class members, and will settle prematurely to avoid relatively unprofitable cost-investment points. These perverse incentives inhibit justice in high-cost cases. A solution—one Professor William Rubenstein and I recently proposed—is to enable direct cost profits in class actions, by, for example, not just reimbursing costs, but applying a multiplier to cost investment.<sup>2</sup>

A precursor to and variant of this idea was rejected in the *Agent Orange* litigation in the late 1980s when the Second Circuit reversed Judge Jack Weinstein's decision for awarding a form of indirect cost profits—the reallocation of a court-awarded fee by agreement of class counsel in order to recognize the value of cost investment.<sup>3</sup> The Second Circuit asserted ethical impediments to cost profits, including, for example, that they created conflicts between class counsel and the class. These impediments have remained largely unexamined by courts since the 1980s.

---

1. Summarized and adapted from Morris A. Ratner, *Class Counsel as Litigation Funders*, 28 GEO. J. LEGAL ETHICS 271 (2015).

2. See Morris A. Ratner & William B. Rubenstein, *Profit for Costs*, 63 DEPAUL L. REV. 587, 612–13 (2014).

3. *In re Agent Orange Prod. Liab. Litig.*, 818 F.2d 216 (2d Cir. 1987).

Times have changed, suggesting that courts may or at least should now be open to more completely harnessing class counsel's incentives to fund class actions, and to doing so directly in the initial fee and cost award. Judges handling complex and large-scale multidistrict litigations have grown increasingly accustomed to addressing the financing function of the plaintiffs' attorneys in preliminary case-management orders, especially in large multidistrict-litigation proceedings. Moreover, *alternative* litigation financing has received attention, exposing litigation financing as an area undergoing dramatic transformation at the margins, whether or not courts choose to guide it.

Courts may or at least should be more willing in this environment to look at change not only at the margins, where alternative funders fill some of the litigation-financing gaps, but at the center of traditional case financing, where plaintiffs' counsel act as litigation funders of first resort. Finally, class-action fee- and cost-award doctrine itself has made major strides since *Agent Orange* away from an exclusive focus on time as the yardstick for fees, creating via the percentage method the opportunity to value other contributions class counsel make, including their role as litigation funders. Against this backdrop, this article reexamines the ethics of cost profits in class actions, as well as the extent to which existing doctrine points towards a measure.

#### *The Disparate Treatment of Time and Costs in Class Litigation*

Entrepreneurial plaintiffs' counsel make two types of investments in class-action litigation—time and money. Time investment includes, literally, the allocation of time—measured in hours—by attorneys employed by or who are members of the firm. Case-specific cost investment includes two types—in-house services and disbursements to third parties. The cost investment necessary to advance class actions varies by type of case, but it is the magnitude of disbursements to third parties that distinguish these cases.

Some tasks necessary to advance a litigation matter are nearly always accomplished via time investment. Cases raising novel legal questions, for example, are likely to be time-intensive, because of the amount of research, briefing, and argument they entail. Other tasks necessary to advance class litigation can be accomplished either via time or cost investment, including projects where technology offers

alternatives to the use of attorney labor, such as in the area of electronic discovery, which allows firms receiving productions of electronic data to select more or less labor-intensive review methods; where non-lawyer legal process outsourcing companies (LPOs) are available to do the work that would otherwise be done in the first instance by the firm's lawyers; and where either a lawyer or a non-lawyer specialist could do the same work, such as reviewing client medical records.

Logically, it is all money investment, from the perspective of the firm serving as class counsel on a contingent fee basis. To the owners of the firm, it costs money to provide overhead for the firm's lawyers to be available to invest time, and that cost can be quantified, e.g., as a cost per lawyer, per hour billed. The firm typically dips into the same well of capital to pay for both overhead (which may be recaptured only via a fee award) and case-specific cost investment including disbursements (which are separately reimbursed as costs). But the fee- and cost-award jurisprudence treats time and other cost investments differently, and thus prompts lawyers to see the two types of investments as producing unequal rewards.

Time investment presents the possibility of being directly profitable in any case in which the lodestar method will or may be used to calculate the fee. The lodestar method must be used in statutory fee shifting cases litigated to judgment (though a settlement, even in a statutory fee-shifting case, can involve the creation of a common fund that generates a fee using the percentage method). Courts also regularly use the lodestar where the value of a class settlement is difficult to ascertain, e.g., because it involves non-monetary relief or an unfinished claims program. The lodestar method may be used in most jurisdictions even in common-fund cases and is regularly used in such cases as a cross check even when the percentage method sets the fee.

Cost investment, on the other hand, though it can be substantial, is merely reimbursed, and produces no direct profit, regardless of the methodology used to calculate the fee award. The standard format of an order awarding fees calculates the fee award separately from the award of costs, noting expressly that costs are reimbursed. While some courts have awarded *less* than the amount of reimbursement sought, e.g., on the ground that the costs submitted were insufficiently documented or were otherwise excessive, courts do not award a direct markup on costs, either by permitting counsel to

charge more than the costs actually incurred or by awarding a multiplier on such costs.

Disproportionately rewarding time relative to cost investment distorts attorney case-investment decisions in a manner that can dramatically affect whether persons with high-cost claims have access to quality representation. If we assume that class counsel are profit-maximizing, then mapping the distortions is a matter of following the money. While a plaintiffs' class-action law firm may be indifferent to the distinction between time and cost investment, it can experience direct profits only on time, not costs.

As a result, the firm will favor time-intensive over cost-intensive cases when choosing which cases to pursue; when given a choice, will invest attorney time rather than costs in a case, even if paying a third-party to perform a necessary litigation task would be cheaper for the class; and will face relatively more pressure to settle prematurely, especially around major cost-investment points, e.g., just before having to invest in high-cost testifying experts. The distortion in class counsel's investment incentives caused by the current bias against direct cost profits thus produces agency costs, including the loss in welfare experienced by the principal as a result of counsel's disloyalty.

The strain of mismatched rewards on time and cost investment is mostly under the surface, invisible to outside observers, except where investing counsel disagree on the allocation of any fee and cost award. In many cases, counsel's investment of time and cost are roughly proportional, so that the fee awarded gets allocated in roughly the same percentage as the overall contribution of time and money. However, in some cases, counsel invest time and costs disproportionately. It is in those cases that the uneven treatment of time and cost investment is most likely to erupt in the kind of conflict that will bubble up to a published decision that reveals the ethical concerns animating the uneven treatment of time and cost investment.

*Agent Orange* is the most famous case. There, at a critical juncture in the litigation, existing counsel had depleted their resources and needed additional cost investment to continue the litigation. To induce such investment, Plaintiffs' Management Committee (PMC) members agreed that cash-investing counsel would receive a three-fold return on their cost investment in the event of a successful resolution of the case. Fees remaining in the

pool (the combined fee and cost award made by the court) after the investment payouts would be split in accordance with counsel's relative time investments. Judge Weinstein, recognizing the need to properly reward cost-investing counsel, was willing to tolerate this reallocation of his fee and cost award.

The Second Circuit reversed on grounds sounding in ethics and procedure: Class counsel's contractual end-run around the court's fee and cost award conflicted with the principles of reasonable compensation in common-fund actions set forth in Second Circuit cases, which at that time centered on counsel's relative time investment via the lodestar method. Moreover, the agreement among counsel to reward cost investment created impermissible conflicts between class counsel and the class because cost-investing counsel were focused primarily on their three-fold return rather than on maximizing the recovery for the class. Not only was the particular allocation agreement among counsel in that case unenforceable but the court also suggested that *all* agreements designed to generate cost profits categorically created unacceptable risks of disloyalty.<sup>4</sup>

#### *The Ethics of Cost Profits*

Are profits on cost investment ethical? That inquiry traverses three doctrinal boundary lines which, as currently drawn, fail to fully acknowledge the distinct role played by plaintiffs' counsel in class actions as litigation financiers and court-appointed fiduciaries: the lines between "professional services" and other charges, consent and its absence, and permissible and impermissible conflicts.

When class counsel acts as litigation funder, directly advancing case costs, is he providing a professional service on which he can reasonably make a direct profit, or is he merely paying a disbursement that is ancillary to the professional service he renders? The answer to this question largely determines whether costs can be a profit center because ethics and class-action fee- and cost-award doctrine assume counsel's professional services in the form of labor are presumptively capable of producing direct profit, but that actions that merely support the labor function are not. While attorneys in other practice settings may not be expected to include litigation funding as part of the package of professional services they offer,

---

4. *Id.* at 223–24.

contingent-fee class counsel must, both as a practical condition of being retained by representative plaintiffs and as a formal matter pursuant to the criteria Rule 23, provide for appointment of class counsel.<sup>5</sup> The distinctiveness of contingent-fee class-action practice can be recognized either by moving the boundary line between professional and other services or by discarding it altogether as a heuristic for defining permissible cost profits in that setting.

To what extent is client consent a necessary precursor to the award of cost profits? Under ABA Model Rule 1.5, as interpreted by ABA Formal Opinion 93-379, cost investment may be directly profitable as long as the bases of cost charges are disclosed to the client, preferably at the outset of litigation, and typically in the representation agreement that commences the relationship. The problem is that both Rule 1.5 and the ABA Opinion interpreting it rest on an assumption that the lawyer-client relationship is contractual, whereas the lawyer-client relationship in class actions is created by court order. In the class setting, there is usually no opportunity to disclose cost profits at the outset of the lawyer-client relationship because fee and cost awards are made *ex post*, after a favorable judgment for the class has been obtained. The question is thus whether it is possible to substitute for or simulate consent in class actions to create a space between express individual consent and its absence. Substituting for express consent involves shifting from a market approach to structuring the lawyer-client relationship to a fiduciary one, a familiar move in class-action jurisprudence that is accomplished by designating the judge as guardian of the class and by giving the court power to appoint and approve any fee and cost award to class counsel. Simulated consent is also accomplished by the adoption of procedures to enable class-member participation, including notice, the opportunity to object to any fee and cost award, and the right to opt out. The need for consent—or at least a facsimile of consent—thus need not be a barrier to cost profits in class actions.

Do direct cost profits create conflicts between lawyer and client? The Second Circuit expressed skepticism about directly rewarding cost investment on that ground in *Agent Orange*. But the relevant question when selecting a fee- and cost-award methodology is not whether the award of cost profits creates conflicts between class counsel and the class—it surely does. The relevant question is

---

5. FED. R. CIV. P. 23(g)(iv).

whether, on balance, a regime that permits direct cost profits is more likely to align the interests of class counsel and class members than does a regime that does not. Prohibiting direct cost profits creates potential agency costs in *all* cases in which the lodestar method will or may be used to calculate the fee and cost award. These costs include the loss in welfare consistently experienced by class members as a result of class counsel's disincentive to make the level of cost investment that best serves class members' interests. If cost profits are enabled, conflicts of the kind noted by the Second Circuit are likely to arise only in limited settings. If the same firm is making both time and cost investment, and if time and cost investment are equally rewarded, then there is no incentive to underinvest in litigation based on the fact that cost investment is directly profitable. The benefit to counsel of premature settlement as a result of the availability of direct cost profits arises only if the reward on time and cost investment is experienced as unequal, either because multiple firms investing in a class action have varying mixes of cost and time investment or because time and cost investment are both potentially profitable but to different degrees.

#### *Calculating Reasonable Cost Profits*

Once we acknowledge that cost profits may be awarded in class actions, the question shifts from their permissibility to their measure. The most obvious mechanisms for delivering direct cost profits would be, as with fees, an initial markup from actual cost to market rate (to the extent any gap exists) and an actual or effective multiplier on costs. The question is not *how* such cost profits might be awarded but whether our existing doctrinal framework gives courts guidance as to the *amount* of such profits in a given case.

A useful starting point is Rule 23(h), which authorizes a court overseeing a class action to award reasonable attorney's fees and nontaxable costs. In class actions fee and cost award jurisprudence, the "market" provides a central touchstone for determining a reasonable fee, though jurisdictions' understanding of and commitment to market principles varies. When determining the fee to award under the lodestar method, courts assess lawyers' hourly rates by reference to the rates charged by lawyers of similar skill, experience, and reputation doing similar work in the relevant market. With regard to percentage-fee awards, some courts have looked to



percentage awards in similar categories of litigation to establish a market measure of reasonableness. What is the market for cost investment in litigation against which the reasonableness of direct cost profits could be assessed? Though there are additional options, two most naturally lend themselves to the project of normalizing of rewards on time and cost investment by class counsel: the market mimicked by judges acting as would sophisticated and informed consumers of legal services; and the market for time investment.

Judges may mimic the market by positing themselves as sophisticated and informed consumers of legal services negotiating rewards on time and cost investment at the outset of litigation. Faced with a fee- and cost-award petition from successful class counsel at the end of a class action, a judge would hew to the agreement a sophisticated client would likely have negotiated at the front end. A sophisticated client would want to reward counsel in a way that minimizes agency costs or, put differently, best aligns the interests of class counsel and the class. As a result, the client would be inclined to eliminate the bias in favor of time investment. Judges could move toward this goal by equalizing the direct reward on time and cost investment. For example, in a case where the court is awarding a percentage fee using a lodestar cross check, the lodestar cross check could include both marked-up time and similarly marked-up costs, with the same multiplier applied to both. Judges acting as sophisticated consumers might go further, not only normalizing the treatment of time and cost investment, but also rewarding counsel for getting the right *mix* of time and cost investment, by, for example, putting the burden on counsel to demonstrate they made the kind of case investment that produced the greatest net award for the class members.

The market for attorney labor may suggest another measure for cost profits. From the investing law firm's vantage point, time and cost investment both involve dollar outlays, time calculated as the firm's overhead per lawyer for each hour of lawyer time available to invest, and case-specific cost investment as dollars paid out. From the contingent-fee client's perspective, time and cost investment are both necessary. For example, the plaintiff in a product-defect lawsuit may need both her attorney's labor and the testimony of a paid expert to establish the defect, causation, or other issues in the case. Both types of investment are equally necessary to establish her claim and are part of the package of services she expects her lawyer to provide

or procure on her behalf. As noted, lawyers enjoy two layers of profit on time investment. The first is the gap between the cost to the firm of supplying attorney labor and the price per hour charged for that labor. A firm might mark up the costs of supplying attorney time by, say, 100 percent; if clients are willing to pay that markup, then it could be argued that the firm's market rate includes a 100% profit on outlays in general—a rule of thumb that could be applied to all outlays, including cost investment. The second source of direct profit on time is the multiplier. Professor Brian Fitzpatrick's comprehensive survey of federal class-action settlements and fee awards reveals that multipliers on lodestar "ranged from 0.07 to 10.3, with a mean of 1.65 and a median of 1.34."<sup>6</sup> Under current practice, only time investment is multipliable. In a regime where both time and cost investment are multipliable, courts may end up awarding lower multipliers to keep the combined amount of fee and cost awards under the new regime in line with current norms. That likely downward trend in average multipliers can be taken into account as a factor in applying the data on rewards on time investment to characterize the market for cost investment.

\* \* \* \* \*

Cost profits have traditionally foundered on ethical shoals. But they need not. A proper reading of the applicable ethics rules would move (or stop drawing) the boundary lines that have prevented parties and courts from more fully exploring opportunities to better align the interests of class counsel and class members. Those poorly drawn boundaries fail to fully recognize the professional role played by class counsel as court-appointed litigation funders. Reasonable profits to compensate class counsel for properly performing that distinctive role may be grounded in market measures, as to which there are ample data.

---

6. Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 834 (2010).